COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Massachusetts Electric Company Nantucket Electric Company	)	D.T.E. 01-71B

INITIAL BRIEF OF MASSACHUSETTS ELECTRIC COMPANY AND NANTUCKET ELECTRIC COMPANY

I. BACKGROUND

On September 7, 2001, the Department of Telecommunications and Energy ("Department") opened an investigation into the quality of electric service provided by the electric distribution companies. Investigation into Quality of Electric Service, D.T.E. 01-71 (2001). The Department stated that the investigation would include, but is not limited to, the service quality plans that Massachusetts Electric Company and Nantucket Electric Company (collectively "Company" or "Mass. Electric") filed pursuant to the Department's June 29, 2001 order in Service Quality Standards for Electric Distribution Companies and Local Gas Distribution Companies. D.T.E. 99-84. In the November 8, 2001 and December 4, 2001 notices of public hearings, the Department stated that it would focus on (1) whether Massachusetts Electric Company met the service quality thresholds established by the Department in Service Quality Standards for Electric Distribution Companies and Local Gas Distribution Companies, D.T.E. 99-84 (2001) beginning May 1, 2000; and (2) if not, what penalties should be imposed by the Department on the Company.

The Attorney General, Division of Energy Resources, and Utility Workers Union of

America are intervenors in this proceeding. The Department held four public hearings, in Brockton, Worcester, Haverhill, and Gloucester. It issued twenty-five information requests and the Attorney General issued seventeen information requests. The Department held an evidentiary hearing on January 28, 2002.

II. STATEMENT OF FACTS

In connection with the merger of Massachusetts Electric Company and Eastern Edison Company, the Department approved a comprehensive rate plan settlement agreement in D.T.E. 99-47 on March 14, 2000 ("Rate Plan Settlement").[1] The Rate Plan Settlement went into effect on May 1, 2000. This Rate Plan Settlement set forth a five year distribution rate freeze followed by another five year period when distribution rates would be capped at 90% of the average rates of other northeastern U.S. electric distribution companies. In addition, the Rate Plan Settlement set forth service quality standards in the areas of reliability, line losses, customer service, and safety by which the Company would be measured ("Original Plan"). The Original Plan gave the Company the opportunity to earn incentives for superior performance and a penalty for poor performance. Pursuant to the Original Plan, the Company is entitled to an incentive of $3,506,000 from May through December of 2000. Revised Exhibit DTE 1-3.

On June 29, 2001, the Department established generic guidelines for service quality

[1]The parties to the settlement were the Associated Industries of Massachusetts, the Attorney General's office, the Division of Energy Resources, The Energy Consortium, Massachusetts Electric Company, Nantucket Electric Company, Eastern Edison Company, New England Power Company, Montaup Electric Company, the New England Electric System, National Grid Group, plc, and Eastern Utilities Associates.

standards in D.T.E. 99-84 ("Guidelines"). It required any company with an existing service quality plan to file a new plan by October 29, 2001 and to provide full and complete support for a service quality plan which deviated from the Guidelines.

The parties to the Rate Plan Settlement had anticipated that the Department would issue generic standards, and the Rate Plan Settlement provides that the Original Plan would be subject to modification if a generic based program was authorized or required by the Department. Rate Plan Settlement p. 26. The Rate Plan Settlement required the Company to consult with the other parties prior to filing revisions to the service quality plan resulting from an order in a generic docket and also required the parties to work together to develop a proposal before the Department. Rate Plan Settlement pp. 26-27. In the Department's order approving the Rate Plan Settlement, the Department stated:

> [T]he Department approves the service quality plan proposed by the Petitioners with the condition or caveat that the Department's order in D.T.E. 99-84 may lead to wholesale replacement, or to significant modifications of some or all of the components of, the Petitioners' plan. These changes might include, but are not limited to, changes in penalties, incentives, benchmarks, benchmarking method, monetary thresholds before penalties (or incentives) are collected from a company (or redound to it), and methods of distributing penalties or collecting incentives. Thus, the proposed service quality plan could be completely replaced, dependent upon the outcome of our generic service quality investigation.

D.T.E. 99-47 pp. 31-32.

Thus, as set forth in the Rate Plan Settlement, the Company met with the Attorney General's Office, the Division of Energy Resources, The Energy Consortium, and Associated Industries of Massachusetts to revise the Original Plan to align with the Guidelines. These parties developed a revised service quality plan ("Settlement Plan") and entered into a settlement

agreement regarding it which the Company filed on October 29, 2001 in dockets D.T.E. 99-47, 99-84, and 01-71. The parties proposed that the Settlement Plan become effective on January 1, 2001. The Settlement Plan aligned the Original Plan with the Guidelines in many ways, but contained some differences, including doubling the maximum penalty for consistently poor reliability, not reducing the maximum aggregate penalties for service guarantee payments to customers, allowing both incentives and penalties, maintaining a threshold of $20 million before net penalties would be refunded or incentives collected until December 2009, continuing distribution line losses as a measure, using a rolling average historical benchmark provided that the trigger for maximum penalties would not be lowed, and setting an eight year term.

In a letter dated October 31, 2001, Hearing Officer Caroline O'Brien directed the Company to supplement its October 29, 2001 filing, the Settlement Plan and accompanying settlement agreement, with a service quality plan that complied with the Guidelines. The Company responded on November 2, 2001 with a service quality plan that complied with the Guidelines.

In a letter to the Company dated December 5, 2001 in D.T.E. 99-84, the Department rejected the Company's Settlement Plan and approved the Company's November 2, 2001 filing, subject to a compliance filing that was ultimately made on December 10, 2001 ("Revised Compliance Plan"). In the letter, the Department stated that the Settlement Plan was not similar in substance or in principle to the Guidelines and did not necessarily provide added customer benefits. The Department did invite the Company to file additional support for the Company's Settlement Plan, however. The Company filed the Revised Compliance Plan on December 10,

2001. Under the Revised Compliance Plan, the Company would be entitled to a $960,916 offset in 2000, which has no value, and a $5,631,665 penalty in 2001. Revised Exhibits DTE 1-3 and 1-4.

The Rate Plan Settlement provides that the Company shall adjust its distribution rates for the effects of any legislative or regulatory changes which impose new or modified existing obligations or duties which individually affect the Company's costs by more than $1 million per year. Rate Plan Settlement p. 11. In addition, the Rate Plan Settlement provides that if revised service quality standards result in a significant difference in the balance of risks, costs and benefits, the quantified differences will be recognized as an Exogenous Factor. Rate Plan Settlement p. 27. Thus, the annual differences between revenues or penalties under the Original Plan and penalties under the Revised Compliance Plan, if greater than $1,000,000, are Exogenous Factors. Exhibit DTE 1-17, Record Request AG 1-2. For 2000, this amount is a $3,506,000 incentive. Exhibit Revised DTE 1-3.

According to the Procedural Schedule, the Company filed the pre-filed testimony of Robert H. McLaren, Mark Sorgman, and James D. Bouford on December 14, 2001. Exhibits MEC-1 and MEC-2. In Mr. McLaren's pre-filed testimony, he set forth a proposed resolution of all service quality issues, including an alternative service quality plan to become effective January 1, 2002 ("Alternative Proposal"). Exhibit MEC-1, pp. 23-27. Overall, Mr. McLaren proposed that the Company be measured by the Original Proposal in 2000, the Revised Compliance Plan in 2001, and the Alternative Proposal for 2002 and beyond. Id.

In its December 5, 2001 letter in D.T.E. 99-84, as described above, the Department set

forth its few concerns with the Settlement Plan, and the Company addressed these concerns in the Alternative Proposal. Specifically, the Company eliminated the $20 million threshold before penalties are paid or incentives are realized, eliminated the inclusion of distribution line losses at this time, and included provisions that update the benchmarks each year to reflect the most recent years' historical performance but ensure that the penalty benchmarks contained in the first year of the Alterative Plan, 2002, are not weakened. MEC-1, pp 21-22. Thus, the Alternative Proposal matches the guidelines except as follows: (i) in the event that the Company's average distribution rates are less than the state-wide weighted average distribution rate, the Company would be entitled to earn revenue incentives, rather than just penalty offsets; (ii) the historical benchmark for each performance measure will be updated each year but the original trigger for penalties will not be relaxed, (iii) penalties for poor reliability will be doubled if there are three or more consecutive years in which the maximum penalty is assessed, (iv) the maximum penalty amount will not be reduced by any service guarantee payments; and (v) the plan will run through 2009, but will be subject to review and amendment by the Department after 2004. Exhibit MEC-1, pp. 25-26.

In addition, Mass. Electric proposed that if the Department accepted the proposed resolution of all issues, i.e. the use of the Original Plan in 2000, the Revised Compliance Plan in 2001, and the Alternative Proposal in 2002 and beyond ("Comprehensive Resolution"), Mass. Electric would waive its rights under the Rate Plan Settlement to claim an Exogenous Event based on the differences between the Original Plan and Revised Compliance Plan. Exhibit MEC-1, p. 25.

III. ARGUMENT

A. The Company's service quality performance should be measured by the Original Plan during the period May 1, 2000 through December 31, 2000.

The Company's service quality performance should be measured by the Original Plan during the period May 1, 2000 through December 31, 2000. The Department approved the Original Plan for use until it issued the Guidelines. D.T.E. 99-47, p. 31-32. The Guidelines, issued on June 29, 2001, and Revised Compliance Filing, made December 10, 2001, should not be applied retroactively to this period.

Applying the Guidelines retroactively is not allowed by law. When parties have vested substantive rights, it is impermissible to apply laws and regulations retroactively. Massachusetts Hospital Association v. Department of Public Welfare, 419 Mass. 644, 656; 646 N.E. 2d 1044, 1051 (1995); Haran V. Board of Registration in Medicine, 398 Mass. 571, 574; 500 N.E. 2d 268, 271 (1986). In Massachusetts Hospital Association, the Supreme Judicial Court stated the plaintiff did not have a substantive interest in the Medicaid reimbursement rates it wished to use, because the Department of Public Welfare had never approved them, and therefore, they never became effective. Massachusetts Hospital Association, 419 Mass. at 656; 646 N.E. 2d at 1044. In Mass. Electric's case, the opposite is true. The Department did approve the Rate Plan Settlement with its attendant Original Plan. Thus, the Company has a vested substantive right in it.

A fundamental rule of ratemaking is that rates are prospective in nature Boston Gas Company, D.T.E. 96-50-D (January 16, 2001) citing Narragansett Elec. Co. v. Burke, 381 A. 2d

1358 (R.I. 1977); New England Telephone Co. v. Public Util. Comm'n, 358 A.2d 1 (R.I. 1976). The rule serves the interests of both (1) the utilities, by preventing regulators from setting rates based on hindsight, and (2) ratepayers, by denying utilities the ability to recover past deficits, also based on hindsight. Boston Gas Company, D.T.E. 96-50-D. Moreover, because the rule prohibits refunds when rates are too high and surcharges when rates are too low, it serves to introduce stability in the ratemaking process. Boston Gas Company, D.T.E. 96-50-D.

Alteration of substantive rights is unwarranted in the absence of clear retroactive intent. Mayor of Salem v. Warner Amex Cable Communications, Inc., 392 Mass. 663, 669; 467 N.E. 2d 208, 211 (1984). In its December 5, 2001 letter to the Company in D.T.E. 99-84 (page 3), the Department suggests that applying the Guidelines retroactively is consistent with the Department's order approving the Rate Plan Settlement, because the order stated that the Original Plan was subject to modification or wholesale replacement by the Department in a subsequent order. The Company acknowledges that the Original Plan is subject to modification or wholesale replacement by the Department, but not retroactively. The Company disagrees that the order in D.T.E. 99-47 made it clear that the Department intended to apply the Guidelines retroactively. After the Department's order in D.T.E. 99-47, the Company fully expected that any subsequent modification of the Original Plan would be prospective and not retroactive. Exhibit MEC-1. pp. 21-23. Since the Rate Plan Settlement became effective in May 2000, the Company has operated in good faith with the understanding that the Original Plan was operative. Exhibit MEC-1. pp. 21-23.

The Department's order in D.T.E. 99-47 is not consistent with retroactive application for

two reasons. First, in its discussion of the Exogenous Factor provision, the Department stated that "this proposed exogenous factor will remain in place only until the Department has developed a generic service quality plan and will continue to exist only if the Department approves a similar threshold." D.T.E. 99-47 p. 29. By the plain language of this section, it is clear that the Department acknowledged that if there was divergence between the Original Plan and what became the Guidelines, the Company would be entitled to exercise the Exogenous Factor provision. For this to be the case, the Department had to envision the application of the Guidelines prospectively only. Under any other interpretation, the Exogenous Factor provision and the Department's comment about it have no meaning.

Second, it makes no sense for the Department to have approved standards which it intended to eliminate retroactively later on. If the Department contemplated retroactive application of the Guidelines, it would have eliminated the Original Plan from the Rate Plan Settlement in its entirety, and simply notified Mass. Electric and the other utilities in the state that it would issue new standards at some point in the indefinite future and apply them retroactively to past conduct. Such an action would have been unreasonable at the time, of course, and it is inappropriate now.

Evaluated under the Original Plan, the Company is entitled to an incentive of $3,506,000 from May through December of 2000. Revised Exhibit DTE 1-3.

B. The Company acknowledges the application of the Revised Compliance Plan in 2001.

The Company acknowledges the application of the Revised Compliance Plan in 2001. As

the Department noted in its order approving the Original Plan, the Department reserved the right to modify or replace the Original Plan once it issued the Guidelines. D.T.E. 99-47, p. 31-32 As the Department issued the Guidelines in 2001, the Company accepts their use in 2001. Under the Revised Compliance Plan, the Company is penalized $5,631,665 in 2001. Exhibit Revised DTE 1-4. The Company has proposed to net the incentives earned in 2000 against the penalties assessed in 2001. MEC-1 p. 24. Consistent with Section I.C.2 of the Rate Plan Settlement, the Company has proposed to refund the net penalties to customers through a uniform and fully reconciling refund factor applied to all kilowatthours billed under the Company's retail delivery rates. The Company has further proposed to refund this amount over a twelve month (or shorter) period as approved by the Department. Exhibit DTE 1-14.

C. The Department should approve the Alternative Proposal effective January 1, 2002 because it will provide substantial benefits to customers.

Unlike the analysis for 2000 and 2001, which rests on the application of law to the specific facts before the Department, the question of whether to apply the Alternative Proposal or the Revised Compliance Plan is a question of policy for the Department. As a policy matter, the Department should approve the Alternative Proposal effective January 1, 2002 because it will provide substantial benefits to customers. As set forth more fully below, the Alternative Proposal increases the penalties for poor performance above the level set forth in the Revised Compliance Plan and adds positive rewards for improved performance. Thus, the Alternative Proposal creates significantly more powerful incentives for enhanced service quality than is currently reflected in the Revised Compliance Plan. The Alternative Proposal provides the

Company with an overall incentive of $31.3 million, ranging from a "worst case" penalty of $18.5 million (a full 45% above the statutory limit for such penalties) to a "best case" incentive of $12.8 million. By extending both ends of the incentive and reward outcomes in this fashion, this overall incentive can be achieved without greatly affecting the expected economic outcome from the overall service quality plan.

This broader variation at the same expected net economic value is designed directly in the Alternative Proposal. The Alternative Proposal and the Revised Compliance Plan are both based on the past statistical performance of the Company. Both have an expected economic value of zero, if Mass. Electric's average performance in the future exactly matches its performance in the past. However, the Alternative Proposal significantly extends both ends of the spectrum of possible performance results, and thus sends a much stronger signal to avoid deterioration of service and to improve over past performance. A comparison of the variation is shown in Exhibits DTE 1-10 and 1-11, which illustrates the effect under both designs of a plus or minus variance in performance by Mass. Electric. In all cases, the total incentive is much more powerful under the Alternative Proposal. This improvement cannot otherwise be achieved because of the statutory limit of two percent of the revenues of the Company, which Mass. Electric has agreed to waive in the Alternative Proposal.

The Company's Alternative Proposal also recognizes the Department's desire for uniformity among the service quality plans of Massachusetts electric distribution companies. With uniform plans, the Department can track and compare performance easily and effectively. To this end, the Company's Alternative Proposal is the same as the Revised Compliance Plan

with limited exceptions. In addition, the Alternative Proposal contains all of the same performance measures and reporting requirements that are in the Revised Compliance Plan.

The Alternative Proposal differs from the Revised Compliance Plan in the following ways. First, in the event that the Company's average distribution rates are less than the state-wide average distribution rate, the Company would be entitled to earn revenue incentives rather than just penalty offsets. Second, the historical benchmark for each performance measure will be updated each year but the original trigger for penalties will not be relaxed. Third, penalties for poor reliability will be doubled if there are three or more consecutive years in which the maximum penalty is assessed. Fourth, the maximum penalty amount will not be reduced by any service guarantee payments. Finally, although the plan will run through 2009, it will be subject to review and amendment by the Department after 2004. MEC-1 pp. 25-26.

As explained above, the Alternative Proposal offers substantial benefits to customers in a manner that cannot otherwise be achieved within statutory constraints. It increases penalties above the levels that would otherwise be authorized under the law. At the same time, it provides an excellent foundation for continuous long-term improvement in service quality by offering both incentives for excellent performance. By providing an additional source of revenue, these incentives can be included in the economic justification associated with the up-front costs required for many service quality improvements. This additional revenue may be critical during a period when distribution rates are otherwise frozen. By providing a longer term, the Alternative Proposal will strongly encourage a long-term effort to achieve continuous improvement in service quality. In addition, the long-term benefits of adopting a balanced carrot

and stick performance based regulatory system are greater than those of a stick only system. The incentive component shifts the Company's focus from avoiding penalties to instituting long-term cost-effective service quality improvements. Exhibit MEC-1, p. 26. As the Company continuously improves service, however, the target for earning incentives gets harder to achieve. MEC-1 p. 27. As the Department noted in the conservation and load management arena, incentives are a means of motivating a company to take an aggressive approach, see e.g. Western Massachusetts Electric Company, D.P.U. 91-44 at p. 114 citing D.P.U. 89-260, and a company that performs in a superior fashion should be rewarded financially, see e.g. Massachusetts Electric Company, D.P.U. 89-194/195 at p. 175. California and North Dakota have both recognized the value of incentives for superior distribution company performance. Record Request DTE 1-13.

In exchange for the ability to earn incentives for superior performance, the Company's proposed Alternative Proposal is stricter than the Revised Compliance Plan with respect to penalties. As previously noted, the Alternative Proposal provides for significantly greater penalties for poor performance than required under the Guidelines or under the law.

Finally, if the Alternative Proposal is approved as part of the Comprehensive Resolution, the Company has agreed to waive its right to adjust its distribution rates based on a service quality Exogenous Factor, eliminating this issue from future proceedings altogether.

D. If the Department rejects the Comprehensive Resolution, the Company will be entitled to make an Exogenous Factor Filing under the Rate Plan Settlement for the quantified difference between the incentives and penalties of the Original Plan and the Revised Compliance Plan.

If the Department rejects the Comprehensive Resolution, the Company will be entitled to make an Exogenous Factor Filing under the Rate Plan Settlement for the quantified difference between the incentives and penalties of the Original Plan and the Revised Compliance Plan. As described above, the Rate Plan Settlement provides that the Company shall adjust its distribution rates for the effects of any legislative or regulatory changes which impose new or modified existing obligations or duties which individually affect the Company's costs by more than $1 million per year. Rate Plan Settlement p. 11. In addition, the Rate Plan Settlement provides that if revised service quality standards result in a significant difference in the balance of risks, costs and benefits, the quantified differences will be recognized as an Exogenous Factor. Rate Plan Settlement p. 27. Thus, the annual differences between revenues or penalties under the Original Plan and penalties under the Revised Compliance Plan, if greater than $1,000,000, are Exogenous Factors. Exhibit DTE 1-17, Record Request AG 1-2. Overall, the Company would have the right to recover the annual differences between the revenues that would have been collected or the penalties that would have been paid under the Original Plan and the penalties that would be due under the Revised Compliance Plan through the period of the Rate Plan Settlement, May 1, 2000 to December 31, 2009. Rate Plan Settlement pp 11, 27; D.T.E. 99-47, p. 29.

In exchange for supporting the Comprehensive Resolution, however, the Company has agreed to waive any rights that it has under the Rate Plan Settlement to make an Exogenous Factor filing on this matter. MEC-1, p. 25. This is a further benefit to customers.

IV. CUSTOMER SATISFACTION MEASURES

During the evidentiary hearing in this matter, there was some discussion of how various customer service measures are to be tracked. The Company notes the importance of working closely with the Department's Consumer Division to ensure accurate records.

V. CONCLUSION

For the reasons set forth above, the Company respectfully requests that the Department judge the Company's service quality pursuant to the Original Plan in 2000, the Revised Compliance Plan in 2001, and the Alternative Proposal in 2002 and beyond.

Respectfully submitted,

MASSACHUSETTS ELECTRIC COMPANY
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By their attorney,

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